

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of

Bell Operating Company
Provision of Out-of-Region
Interstate, Interexchange
Services

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CC Docket No. 96-21

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COMMENTS OF EXCEL TELECOMMUNICATIONS, INC.

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SUMMARY OF COMMENTS OF EXCEL TELECOMMUNICATIONS, INC.

In its Comments, Excel Telecommunications, Inc. ("Excel") proposes that the Commission impose stricter separation requirements upon the Bell Operating Companies ("BOCs") before affording them nondominant treatment in providing out-of-region interexchange services. Excel believes that at least until the Commission has made a final determination regarding its separation requirements in its upcoming interexchange proceeding, it should require the BOCs to observe the following requirements:

- BOC out-of-region services should be required to comply with the same structural and transactional requirements which the Telecommunications Act of 1996 ("Act") expressly applies to BOC in-region interexchange services. Specifically, Section 272(b) requires the separate affiliate to 1) operate independently from the BOC; 2) maintain separate books, records and accounts; 3) have separate officers, directors, and employees; 4) not obtain credit under terms that would permit a creditor, upon default, to have recourse to the assets of the BOC; and 5) conduct all transactions with the BOC on an arm's length basis which are preserved in writing available for public inspection.
- The BOCs which wish to provide out-of-region services through a separate subsidiary should be required to meet three standards proposed in the Commission's Notice. Specifically, the BOC affiliates would be required to 1) maintain separate books of account; 2) not jointly own transmission or switching facilities with the BOC local exchange company; and 3) obtain any BOC exchange telephone company services at tariffed rates and conditions.
- The BOCs should be prohibited from promoting or marketing their local exchange monopoly services in conjunction with their interexchange affiliate offerings.
- Finally, the BOCs should not be allowed to discriminate in favor of their interexchange affiliates in the provision of non-Title II services such as billing and collection.

As demonstrated below, the BOCs have both the incentive and ability to leverage their

local exchange monopoly power in order to benefit their interexchange affiliates. Such potential anticompetitive abuse includes the use of cross-subsidies and expense shifting between their out-of-region interexchange services and their local service monopolies, as well as disadvantaging competitors by affording discriminatory access to bottleneck monopoly facilities. While the Act contains provisions to safeguard against such abuses, many of these provisions will not be given force and effect until the Commission first concludes implementing rulemaking proceedings.

Perhaps most importantly, however, the history of telecommunications regulation teaches that structural separation and accounting requirements have been notoriously ineffective in preventing anticompetitive conduct on the part of the BOCs. As Excel explains in its Comments, the view of the U.S. Department of Justice in proceedings leading up to the AT&T consent decree has been that regulatory safeguards are essentially unworkable in addressing abuses stemming from cross-subsidization and the subtle forms that discrimination may take. The point is that BOC potential for anticompetitive abuse has shown a historical tendency to evade regulation and, in light of this, the Commission should adopt maximal structural safeguards in this proceeding.

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COMMENTS OF EXCEL TELECOMMUNICATIONS, INC.

Excel Telecommunications, Inc. ("Excel"), by its attorneys and pursuant to the Commission's Notice of Proposed Rulemaking released February 14, 1996 ("Notice"), hereby submits its Comments in the above-captioned proceeding.

I. INTRODUCTION

Excel is one of the fastest growing providers of long distance telecommunications services in the U.S. As a reseller which commenced operations in 1989, Excel provided service to approximately 1.9 million residential and small business customers as of December 31, 1995. The Company offers a variety of long distance services and products, including residential service, commercial service, 800 service, international services and calling cards. As a reseller with a substantial customer base located throughout the country, Excel's operations stand to be substantially impacted by the instant proceeding.

Excel supports the Commission's proposal to treat the Bell Operating Companies ("BOCs") providing out-of-region interexchange services as dominant carriers. Excel is not opposed to affording BOCs nondominant treatment so long as adequate separation requirements

are applied. As shown below, the separation requirements proposed in the Commission's Notice would not afford adequate protection against potential anticompetitive abuse on the part of the BOCs and, thus, should be strengthened.

In particular, Excel proposes that the Commission, at least in the interim, require BOCs providing service through separate affiliates in out-of-region markets to comply with the separate subsidiary requirement set forth in Section 272(b) of the Telecommunications Act of 1996 in addition to the requirements proposed in the Notice. Additionally, the Commission should prohibit BOCs from promoting or marketing their local exchange monopoly services in connection with their interexchange affiliate offerings. Lastly, the BOCs should not be permitted to discriminate in favor their affiliates in the provision of non-Title II services such as billing and collection services.

II. THE SEPARATE SUBSIDIARY REQUIREMENT APPLICABLE TO BOC OUT-OF-REGION INTEREXCHANGE SERVICES SHOULD BE STRENGTHENED

The Commission's Notice recognizes that the BOCs will "continue to control bottleneck facilities in their in-region states." Notice at paras. 9 and 12. The Notice references the Commission's 1980 ruling in CC Docket 79-252 which cites AT&T's then-control of bottleneck facilities as "prima facie evidence of market power requiring detailed regulatory scrutiny." Id. While the BOCs do not possess market power in the interstate, interexchange market, they do possess market power in their in-region local exchange markets, and that market power can be leveraged for anticompetitive purposes in the interexchange market.

The fact is that while the doors to local competition are being opened,¹ the BOCs remain

¹ According to the most current NARUC Report on the Status of Competition in Interstate Telecommunications, ten states do not even permit local exchange competition, while an

bottleneck monopolists in local exchange markets. The BOCs' continuing monopoly power was acknowledged by the U.S. Court of Appeals in 1990. According to the Court, "[t]here is no dispute, at least not on appeal, that the BOCs still possess their bottleneck monopolies in local exchange services. Despite certain technological innovations, only a minute percentage of telephone users can bypass the local exchange carriers for any of their calls."² Although local exchange markets have continued to open, the BOCs remain dominant in their local exchanges, and the Court's statement rings just as true today.

As a result, the BOCs will be able to leverage their local exchange market power upon entry into out-of-region interexchange markets. As long as a BOC is engaged in both monopoly and competitive interexchange activities, it will have both the incentive and ability to divert revenues from or add inappropriate expenses to its monopoly business in order to subsidize its interexchange venture and thereby undersell its rivals in long distance markets. Over a period of time, a subsidized BOC interexchange affiliate may be able to drive enough competing firms out of the market as to destroy or impair competition.³ The result is that the BOC becomes a monopolist in that market as well. Consequently, unregulated telecommunications prices increase and the range of products and services available narrows.

In the case of interexchange voice services this threat is realistic. It is by no means a

additional ten states are either undetermined as to whether they permit local exchange competition or only partially allow it. See NARUC Report on the Status of Competition in Interstate Telecommunications, August 1995 Update, at 167-170.

² United States v. Western Electric Co., Inc., 900 F. 2d 283, 295 (D.C. Cir. 1990), *cert. denied*, 498 U.S. 911 (1990).

³ Significantly, this would occur at the expense of captive exchange services ratepayers who, through inflated rates, would subsidize this outcome.

distant possibility that either a single BOC or the BOCs as a group could, through various types of cross-subsidies and favorable treatment of its own interexchange affiliates, monopolize interexchange traffic outside of its own, or their own, regions.

Such cross-subsidies could include, for example, misallocation of common costs (including facilities, equipment or personnel) as well as transferring assets from monopoly operations to competitive affiliates at less than their cost or book value. While Section 254(k) of the Act generally prohibits the cross-subsidization of competitive services with monopoly revenues, it requires the Commission and the states to establish the necessary safeguards to implement the requirement.⁴ Until these safeguards have been put in place, the primary defense against improper cross-subsidies will come from the separation requirements adopted in the instant proceeding.

In addition to cross-subsidies, BOCs in out-of-region competitive markets will have the incentive to discriminate against competitors in those markets by denying them efficient access to bottleneck local exchange facilities or by failing to provide timely information on network operating characteristics. Such discrimination can be varied and subtle, including discrimination in the design of access services to favor BOC interexchange operations; discrimination in the provision of network information; and delays in access provisioning and maintenance to competitors. Here too, while the Act contains important restrictions against discrimination,⁵ it will not be until the Commission has concluded implementation proceedings that actual safeguards will exist.

⁴ Act, 47 U.S.C. §254(k).

⁵ See, e.g., Act, §§251(c)(2) and (3), 252(i) and 222(c)(3).

These concerns are not overstated; indeed, history teaches that structural separation and accounting requirements have been notoriously ineffective in preventing anticompetitive conduct on the part of the BOCs. As the Department of Justice ("Department") concluded in 1982 in commenting on the then-proposed AT&T Consent Decree:

[P]articularly in a technologically dynamic industry such as telecommunications, there is little possibility that regulation is capable of detecting or preventing the very subtle forms of discrimination that would be available to the BOCs.... Even if it were possible, moreover, effectively to monitor the technical aspects of interconnection in an evolving environment, there would still remain more subtle means of discrimination in operational activities, such as the timely provision, maintenance, testing and restoration of facilities. In short, the BOCs, if permitted to engage in competitive activities, would have substantial ability to frustrate regulatory attempts to prevent discriminatory conduct.⁶

It was the inability of regulatory safeguards to prevent anticompetitive abuse which, in part, initially led to the divestiture of AT&T. According to the Department:

At the heart of the government's case in United States v. AT&T was the failure of regulation to safeguard competition in the face of powerful incentives and abilities of a firm engaged in the provision of both regulated monopoly and competitive services. Neither of these problems [cross-subsidization and discrimination] has thus far proven amenable to successful regulatory solution. Indeed, the very basis for divestiture is that the anticompetitive problems inherent in the joint provision of regulated monopoly and competitive services are otherwise insoluble.⁷

As the Department recognized prior to the entry of the AT&T Consent Decree, the Commission has struggled unsuccessfully for more than twenty years to solve the cross-subsidization and discrimination problems.⁸

In view of the history of the Commission's previous regulatory efforts involving

⁶ Response of the U.S. to Public Comments on Proposed Modification of Final Judgment, 47 Fed. Reg. 23,320, 23,336 (May 27, 1982).

⁷ Id.

⁸ Id.

structural separation as well as the substantial market power still possessed by the BOCs, Excel believes that any separation requirements applied to BOC out-of-region interexchange affiliates should be maximum separation requirements. The three requirements proposed in the Notice would only partially operate to prevent anticompetitive abuse. In fact, the Commission admits as much in its Fifth Report and Order in CC Docket 79-252.⁹

Instead, Excel proposes that the Commission apply, at least on an interim basis, the same structural and transactional requirements which Section 272 of the Act imposes on BOC in-region interexchange services¹⁰ in addition to the three requirements proposed in the Commission's Notice.¹¹ Although the Act does not specifically require these conditions for BOC out-of-region interexchange services, they are readily applicable to such services. Moreover, such requirements should not be unduly burdensome since the BOCs must establish a subsidiary subject to such requirements if they wish to provide in-region interexchange services.

In addition, the Commission should prohibit a BOC from carrying out any promotion, marketing, sales, or advertising for or in conjunction with its interexchange affiliate which is

⁹ Notice at para. 10. See also Fifth Report and Order (FCC 84-394), CC Docket No. 79-252, released Aug. 27, 1984 at para. 9.

¹⁰ Section 272 requires the separate affiliate to 1) operate independently from the BOC; 2) maintain separate books, records and accounts; 3) have separate officers, directors, and employees; 4) not obtain credit under terms that would permit a creditor, upon default, to have recourse to the assets of the BOC; and 5) conduct all transactions with the BOC on an arm's length basis and be preserved in writing available for public inspection. See Act, 47 U.S.C. §272(b).

¹¹ Both the Act and the Commission's Notice would require that the BOCs maintain separate books of account. While the Commission may wish to later prescribe specific rules to implement this requirement as required by the Act, the Commission could initially apply this provision in accordance with its existing rules.

related to the provision of monopoly local exchange services.¹² Finally, the Commission should not allow a BOC to discriminate in favor of its affiliate in the provision of non-Title II services such as billing and collection services.¹³

According to the Commission, the separation requirements proposed in the Notice are intended to be applied on an interim basis. Notice at para. 11. The Commission intends to revisit the requirements in its upcoming interexchange proceeding and determine at that time whether it may be appropriate to modify or eliminate the separation requirements. Id. Excel submits that the Commission should proceed more cautiously in the interim period: the initial adoption of more stringent, not less stringent, separation requirements would best serve the public interest. This approach is suggested not only by the lessons of history, but also by the fact that Commission rules and procedures to implement the safeguards against cross-subsidization and discrimination contained in the Act have not yet been adopted. By adopting maximal separation requirements now, the Commission would err on the side of caution. If, in its upcoming interexchange proceeding, the Commission further examines this matter and determines that relaxation is warranted, it could accordingly scale back the requirements.

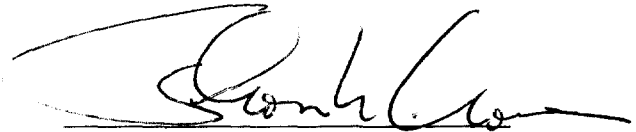
¹² Specifically, BOCs would have the incentive and, unless the Commission acts to prevent it, ability to market in-region local and/or long distance services to out-of-region long distance customers and vice-versa. This could occur, for example, in a circumstance where an out-of-region interexchange customer notified the BOC to terminate its long distance service due to a geographic relocation. Absent appropriate restrictions, the BOC could inquire as to the region of the country that the customer planned to relocate to and, based on information unavailable to competitors, "pre-sell" that customer if it was relocating to an area where the BOC also provided in-region services. A BOC would also have a similar undue advantage in the case of a business customer which has offices located in both in-region and out-of-region areas.

¹³ Specifically, to the extent that a BOC offers billing and collection services to its affiliate, the Commission should require it to offer the same services to all other carriers on identical terms and conditions.

III. CONCLUSION

For the reasons indicated above, the Commission should strengthen the separate subsidiary requirements applicable to BOC out-of-region interexchange services.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Thomas K. Crowe", written over a horizontal line.

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